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THE BANK OF ENGLAND

AND

THE FINANCIAL IMPASSE

BY

T. W. HUSKINSON

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THE BANK OF ENGLAND
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THE FINANCIAL IMPASSE

BY

T. W. HUSKINSON

Author of
"The Bank of England's Charters the
Cause of our Social Distress (1912)."

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" He attacked the Bank of England whose ' cumulative blunders have cost the nation during the past 12 years more than would have sufficed to put through a gigantic scheme of industrial, agricultural and social reconstruction.' "

" Mr. Lloyd George said he was opposed to any interference with the joint stock banks."

" *The Nottingham Guardian,*" *referring to Mr. Lloyd George, Friday, Jan.* 18, 1935.

The Bank of England and the Financial Impasse

RULES OF THE BANKING GAME

Problem of an Adequate Gold Reserve

THE most terrible disasters often spring from the slightest cause, and the authors of the original charter incorporating the Bank of England had no suspicion that the apparently innocuous clause, forbidding any establishment of more than six partners the right to issue notes payable on demand within sixty miles of London, would entail two centuries of social distress, the Industrial Revolution, and end with the present world-wide disaster. The whole arrangement appeared to be simple, reasonable and equitable.

But this arrangement prevented any association of bankers and merchants, such as the present London Bankers' Clearing House, combining to hold for safer custody their own gold reserves, which reserve of this form of " present capital " is absolutely necessary for any settlement of the foreign exchanges on an equitable basis.

The central institution, a general term for the Bank of England, undertook from its first meeting to accept cash balances in the form of a credit entry, and the undoubted connection of the Treasury with this central institution made this the safest way to hold balances of cash credits ; it gave priority of demand on its note issue and by means of this on the sole gold reserve.

But the Bank's customers were also the Bank's creditors and, while thus the outside banks were relieved of keeping any gold reserve against their own commit-

ments, the whole responsibility of maintaining any adequate reserve of gold fell on the central institution, a function no single institution can possibly perform.

Controlling Credit

Though this gave the central institution the power of controlling credit by its rates for interest, its variation, when coming as a surprise, periodically landed the outside market in ruinous difficulties. A national crisis in 1796 brought the Bank itself to a bankrupt condition; the Treasury had to come in to support, and the power to demand payment in the Bank's gold had to be suspended for twenty years, and the process has had to be repeated six times since—the Bank Note becoming merely a currency credit bill.

By the "Forties" of the nineteenth century, when ruin almost as complete as that now threatening impended, it was clearly perceived that the situation was thoroughly unsound and an attempt was made to establish a sound bullion warrant, a result disappointed by an oversight. The predominant position which our vast foreign trade banking, shipping and investments has given England makes a sound financial basis here imperative, or other countries will be thrown in utter confusion; but the recovery of a sound position in England by re-establishing our gold standard would everywhere ease the situation.

The means of doing this have accumulated during the past two years, when the gold reserve at the central institution has doubled to one hundred and ninety millions. Now whilst our pocket money in the form of a currency note based on the general credit will meet the necessities of the internal circulation, the customers' deposits at the Bank of England nor that Bank itself cannot be paid and cleared off in that simple fashion. The deposits of customers at the central institution must be met in gold (sovereigns), and the Bank itself must be in a position to back its own reserve in the same medium.

Futile Conferences

The gold in the Bank will about meet these two amounts, and any shortage the Treasury must repay out of the old eleven million loan in the same medium. Parliament and international conferences are proved futilities in this matter and only add to the general confusion; but it should be possible for the managing directors of the clearing house banks and the Governor of the Bank of England to meet in a parlour and arrange what portion of the gold should be earmarked to each account; it is merely a transfer of book entries, and for the Treasury to ordain that the Bank's power to commandeer outside gold reserves of banks shall cease.

In June, 1933, "Lloyds Bank Review" had a most valuable article by M. Frederic Jenny, financial editor of *Le Temps*, on the English position. He wrote:

"What can we ask of the Central Banks of countries which have maintained or restored the gold standard? How will they, by mutual agreement, be able to secure the normal functioning of the system? Simply by respecting the rules of the game. These rules are in reality very simple.

"Firstly, each one of these Central Banks must allow the gold for which it is asked to go out freely and without restriction, and conversely must accept all gold offered to it.

"Secondly, a country to which gold tends to flow in vast quantities must not endeavour to attract the metal, but, on the contrary, it should restrict this inflowing by a policy of cheap money; on the other hand, the nations which are losing gold in disturbing proportions should endeavour to retain or attract capital by a policy of dear money. Such are the rules of the game. There are no others and they ought to suffice."

Our central institution has no doubt got itself into a considerable tangle in attempts to bolster up credits and accounts in various countries, but the facts, when known and inquired into, should allow adjustment.

Essay No. I.—HISTORICAL SKETCH

There has been little effort made the last half-century to trace our monetary trouble to its source, but this was not the case formerly. By 1844 there was a considerable consensus of opinion that the root evil lay in the statutory constitution of the Bank of England.

According to Lord Coke, "To trace the source of an error is to confute it," and that is the attempt of this present essay.

There is a considerable volume of evidence that from the year 1700 the social condition of this country went from bad to worse, though coupled with the surprising fact that accumulated capital increased beyond all previous experience. There was, however, the new phenomenon of frequent periodic monetary crises and severe competition in trade.

Eighteenth Century Depression

Although his main argument may be open to question, the *resumé* of our social and commercial history from the year 1688 given by Thomas Doubleday, in his Letters to his sons in 1847, is a very complete one. From Doubleday, from Lord Bolingbroke, from the Parliamentary committee of enquiry under Sir John Sinclair as to our distresses after the American War of Independence, all conduce to show that the Eighteenth Century was a period of continuous depression in agricultural and social welfare, which in the end drove the main body of the smaller gentry and freeholders from the land and the craftsmen from the countryside into the factories of the growing towns; the increasing severity of a competition to secure adequate profits was already forcing the combination of capital. It was during this period of fluctuating prosperity that the new experience of gluts of idle loanable money during depression was observed,

which on one occasion caused the wild speculation of the South Sea Bubble.

Suspicion arose whether the constitution of the Bank of England had not imported an evil principle, a dominant check to freedom of exchange. Bolingbroke in 1735 frankly termed the Bank's Charter as "that scheme of iniquity"; though he admitted that "we, who came after them (the authors) and have long tasted the bitter fruit of the corruption they planted, were far from taking such alarm at our distress and dangers as these deserved." (Study of History. Letter 2.)

Before Sir John Sinclair's Committee could report in 1793, war broke out with France, and as usual, whenever the Bank of England encounters a national crisis, the falseness of its constitution was declared and the Bank closed its doors; as we now euphemistically call this form of bankruptcy, the Bank "went off the Gold standard."

Pitt's Order in Council, 1797

This experience is so nearly identical with our own in 1914 and September, 1931, that it demands more than a passing reference. The closing of the doors of the statutory dominant bank brought every activity of the country to a complete standstill. Just as in 1914, when the late Sir E. H. Holden and four representative clearing house bankers went with a proposal for emergency currency the Thursday before the war, Mr. Asquith and Mr. Lloyd George turned it down till forced thereto by the Bank of England closing down on the Saturday following.*

Pitt's financial acumen was superior to our own: his order was brief—the Bank was forbidden to cash its

* The Author called on Sir E. H. Holden, with whom he had been on friendly terms some years, two weeks before the War, and asked if he had prepared a scheme for an emergency currency in the event of a national crisis, because in view of the false position of the Bank of England we might be brought to a stand before a shot was fired. Sir Edward gave an assurance that he and four other leading bankers were prepared with a plan for that event.

notes in gold: no embargo was placed on the sale of the Bank's gold or any movement of it trade required; nor was there any interference with the natural course of exchange throughout the whole period of the twenty year War that followed. The extraordinary revival that followed, the titanic exertions over a lengthy period that this country was enabled to make, the heroic courage in the face of tremendous odds that the power to make those efforts gave rise, were then and are still a matter of marvel.

Adequate Bullion

The Bank's notes being thus reduced to a trade currency bill, the gold was left to look after itself and the result was a larger and adequate supply of bullion. It is, however, fair to remark that after Pitt's death there arose a large and serious premium on gold never publicly explained satisfactorily by the Bullion Committee. A few years subsequently, the "Edinburgh Review" gave the correct explanation. By the Usury Laws more than 5 per cent. interest on loans was forbidden. By 1810 trade was so prosperous the Bank had difficulty in meeting the demands for accommodation, and refusal to discount spread alarm, ruin and a drain of gold *into the country*. Frightened at this, the Bank continued to discount at the maximum rate the law allowed, which, under the circumstances of the great activity due to trade being free from the shackles under the Bank Charter, was far too low. Credit thus passed at too cheap a rate, and speculators stepped in to borrow it, the currency became inflated and, labour thus robbed, the closing years of the war were gloomy and distressed. Thus the mischief arose from another government interference with trade. As Goschen remarks, "Interest is the safety valve of commerce."

The record of the period from 1815 to 1854 is generally known as one long period of distress and a degradation of the working classes unknown before or since, severe

financial crises occurring every three or four years. It is instructive to note the position of Scotland during this period, in which country were no internal crises. Sir Walter Scott had secured to the Scottish banks the right to issue £1 notes, the security thereon demanded and the rate charged for use maintained the note at parity; but there being no dominant bank of issue, the internal circulation was, unlike England, unaffected by the state of the foreign exchanges. Scotland, which a century previous had been a laughing stock for its poverty, became the one prosperous and efficient quarter of the United Kingdom. Scotland has a Currency orbit of its own.

Lord Overstone's Boast

On Peel's accession to power in 1842, Jones Loyd persuaded him to reform the Statutory constitution of the Bank. The situation in the country threatened, as it does now, total collapse and the danger of an irruption of violence. Jones Loyd, afterwards Lord Overstone, demonstated that the condition of affairs did not originate in any fault inherent to a credit system, nor was it due to any irresponsible feeling of the mass of the wage earners; but was entirely due to the successive Charters to the Bank, whereby that Institution was obliged to attempt incompatible functions. It is not possible, he declared, for the Bank as a business establishment to sustain the general credit, which its statutory dominant position entails, as well as its own. Thus every reviving period dug its own grave; buoyancy increased demands on the Bank, and the Bank's action in strengthening its position to meet this, spread ruin and alarm in the Market: "The Bank can save itself under any circumstances by the ruin of all around her" was the proud boast by the mouth of Lord Overstone.

Peel was persuaded to separate the Bank into two departments under his Act of 1844. The banking department was left to its own management and its position

as the Treasury's financial agent. The issue department was to hold the gold reserve, virtually the Treasury acting as Trustee, with a rule of "notes for gold and gold for notes."

The Government, however, owed a huge sum to the Bank, originating in a loan of over eleven million in exchange for a Charter nearly a century earlier. To avoid paying this off, which is necessary if there is to be any return to sound finance, in order to give the Bank full command of its own resources, Peel granted the banking department of the Bank the use up to this amount of the notes of the Bullion department, which by 1914 had been increased under various pretexts to 19½ millions.

This issue being based on credit vitiated the whole issue as a bullion warrant, and threw back on the banking department the sole responsibility of maintaining the parity of the whole issue with its standard of value.

The falseness of the situation was not long in declaring itself. To save the Bank and avoid widespread ruin, the Act had to be suspended in 1847, 1857 and 1866.

The Golden Age

In 1866 it had to be confessed that the duty of sustaining the general credit of the country still rested with the Bank, which, as one governor observed, was as vicious a principle as could be enunciated.

The period between 1854 and 1874 was the Golden Age of the Nineteenth Century, its buoyancy exceeded any experience of 150 years back. The disappointment in Home enterprise of the forty previous years had induced huge yearly investment of money abroad, which acting on the exchanges as an import had induced internal monetary stringency. From 1854 to 1874, investment abroad and income on the previous investments generally balanced. Moreover, the strong commercial position and the better system of France helped to steady the silver exchanges.

After 1874 the income from our foreign investments and services vastly increased, and made London more and more the financial centre of the world: also such payments as Boxer indemnities and reparations accentuated the increasing difficulties. In fact, under our present system, there is a logical end to any possible increase to loans abroad—as Professor Schumpeter of Bonn recently reported to Lloyds Bank, these loans in the end make matters worse, these strangle the debtor or spell loss to the creditor.

Another form of Loan Fund must be discovered to accommodate a balance in an exchange.

The Great War

The War of 1914 need only be briefly referred to. The Bank of England was the only bank about which the public was nervous and where people queued up for cash; no one wanted to be left nursing the fiduciary baby. The Bank closed its doors, we bungled through the financial maze, the Treasury committing every error of the medieval 15th century. Credit banking came to no full stop even during the five days the doors were closed; by post, cheques were drawn and paid in.

However, we got through the War somehow with a huge debt, which Mr. A. H. Gibson in his report to the British Association alleges would have been less by near two thousand million but for the plausible but utterly mischievous "Excess Profits Duty." The debt might have been almost nominal had the gold reserve been held in a more natural manner previously.

During the years 1919—1920, Agriculture, Commerce and wage-earners were prosperous and buoyant. Although gold was about 120s. per ounce in the market and an inflation of the currency was alleged; it is a question whether most of the prosperity could not be ascribed to the public being free from shackles on Trade. It was certain the Bank's gold reserve was impounded.

After 1921 came the first slump. Had the Bank of

England's demand for the bankers' gold reserves at this time any connection? The Midland Bank did hesitate, and had Sir E. H. Holden been alive it may have surmised he would have refused in very forcible terms.

Gold Standard Act

In 1925 came the Gold Standard Act, and a further slump followed. In 1928 came Churchill's Act, which gave the dominant Bank of England absolute power to commandeer any reserve of gold over £10,000. This put an end to any free movement of the reserve of the standard of value; prices and exchanges went rapidly to pieces, until in September, 1931, the country was forced off the gold standard for the seventh time, or, crudely if applied to a common bank, the Dominant Bank could not meet its engagements.

In stating that since the foundation of the Bank of England and on account of its constitution the social condition of the English has gone from bad to worse ever since, and its history for large masses of the people has been a long-drawn-out social tragedy, the query will arise how to account for the enormous increase in the capital wealth of the country, both in home and foreign possessions, and the increase in the population rendered necessary to work it.

McCulloch's Comment

McCulloch, in a note to his edition of Adam Smith, makes the answer easy. He is commenting on the undoubted increase of capital in spite of the huge expenditure and wastage during the long wars preceding 1815. He allows that our immunity from invasion gave security denied elsewhere, but questions whether, had the period been peaceful, the increase would have been so great: "The gradually increasing pressure of taxation stimulated the industrious portion of the community to make corresponding efforts to preserve their place in

society, and gave a spur to industry and invention and produced a spirit of economy that we should have in vain attempted to excite by less powerful means. Had taxation been very oppressive it would not have had this effect; but it was not so high as to induce despair, though it was at the same time sufficiently heavy to render a considerable increase of exertion and parsimony necessary to prevent it from encroaching on the fortunes of individuals. To the excitement afforded by the desire of rising, the fear of falling super-added an additional stimulus, and the two produced results that could not have been produced by the unassisted operations of either. Had there been no War there would have been less industry, less frugality," and as McCulloch concludes, probably less Capital. (Chaper 3, Note 1).

The keen and falsely induced competition of capital for a profit of the last century would have the same result. The savings of this frugal, parsimonious class could only be employed to personal advantage by adding to productive capital demanding an increase in a factory-driven population. Had the times been easier we should have had less frugality, more comfort, more refinement, and a smaller but more desirable class of population.

Remedial Measures

In considering remedial measures, it is desirable to quote an actual example. In 1894, the United States of America were involved in severe unemployment troubles attributed by the masses, led by Bryan, to the huge annual income on English investments due to London. The Banks had used the Treasury at Washington as their reserve of Currency, and thus the financial system of the States closely approximated to our own. In 1896, the New York bankers became alarmed at the possible erratic courses of the politicians at Washington and associated to keep their own reserve of gold independent of the Treasury. This is about equivalent

to our Clearing House bankers, to escape the domination of the Bank of England, withdrawing their balances thence in gold and keeping their bullion accounts direct with the Clearing House.

Great prosperity followed to the States and overflowed into Canada on this reversion to a natural system and freedom from the relying on a Central Bank with a single reserve. The strength of this was tested in 1907 when a prolific harvest strained the resources of the Western Banks to move it, and support from New York was requested.

The deposits in the New York Banks had been hugely increased by the period of prosperity and the support could be easily accorded: but there was a Law that one-third of the deposits must ever be kept in reserve. An unusable reserve was manifestly an absurdity. Would the Treasury at Washington enforce the Law? London was in a panic; New York ignored the Law and gave the support; Washington remained passive and the crisis was over. *The art of Governments is to know how to let alone.*

The formation of a State Federal Reserve about 1912 put an end to this. In 1918 Sterling fell to a discount in New York, which would have been impossible had New York Banks been under their former free and natural system: the final results we now see in 1932.

In 1898 the whole of the above matter was a subject of discussion in London banking circles, but was interrupted by the Boer War. In 1903 Herbert Tritton, President of the Bankers' Institute, proposed the establishment of an independent gold reserve as an urgent necessity: viz., that the bankers subscribed to a gold reserve which, though held at the Bank of England, should not be merged in the Bank's figures but be at the absolute disposal of each subscriber in detail.

Gold Reserve

Sir Edward Holden did form a gold reserve at the Midland Bank to its great advantage. A Gold Reserve

is an absolute necessity for a great commercial country as a reserve of "present capital," which gold is in its utmost concentrated valuable form.

This gold reserve would be a loan fund, options on which could be borrowed at interest by those having foreign balances beyond mutual claims to clear. These options could command Sterling credits at full *par* till the goods such excess of foreign bills represent can reach their market, which could thus be sold at *prices* equal to cost *values* and the resultant Sterling redeem the option on the gold.

This gold reserve should be kept in multiple hands free of Treasury control, so that "the higgling of the market" can find out the amount required, and the interest on the options kept sufficiently high to make it more profitable to keep the gold in the reserve rather than to withdraw it for export.

It is impossible to shift the money of one country to another except in the form of goods, and when the mutual claims still leave a balance, the loan of this gold fills the gap temporarily to effect the daily clearance and prevent the foreign over indebted currencies falling to a discount, leading to an import of goods at prices ruinous to home enterprise and finally forcing the foreign country or dominion to default.

For the English authorities arbitrarily to maintain a balance of the exchange must be ruinous. How can a country with several hundred million of income due from all the world for investments and services maintain a balance in goods or money except by sacrificing all?

Cause of Long Tragedy

The Treasury has called for 350 million for some such reserve to be managed by itself and the Bank of England; but this is just the management that has caused English history to be a long-drawn-out social tragedy for 200 years. Sir Robert Horne truly said it would enable the Treasury to make the value of the £1 what it liked.

Could any system be more wicked or dangerous ? This scheme may, however, provide machinery for initiating Mr. Tritton's plan mentioned previously.

In forming an independent gold reserve, the Treasury would have to refund its debt to the Bank of England of 11½ millions to give that Bank full control of its resources and itself secure a large holding in this profitable free reserve. This must be refunded in sovereigns not " pounds sterling."

The Bank of England would remain the Government's agent, and have the control of the internal currency note issue.

In 1928, the Treasury had an asset of 28 million in gold. What became of it ?

The Bankers' deposits in the Bank of England are profitless and would be drawn on to form this profitable, new, independent gold reserve and the Bank of England might be constrained to offer interest on its deposits like one of the common banks, but this would draw custom and be much to its advantage as a Bank. These deposits are a first claim on the gold reserve at full gold parity.

London's Creditor Position

The effects are world-wide, partly because other countries have copied our system under the impression that England's power of expansion was due to its financial system. This is in part correct for the reason explained in a previous paragraph on McCulloch's note, though it has had a vicious result.

But a great part of the disturbance is due to England's overwhelming creditor position, making London the great international exchange centre with no adequate prepared machinery to accommodate the balances. Thus when there are no loans or re-investments there to clear a balance in such a country, its currency falls to a discount in London till the daily equality of payments is reached. The effect of this on prices by this

falsification in exchange owing to our system is attributed to foreign competition.

The reason why an independent reserve of " present capital " in London, as a loan fund to support these temporary balances in payments, must be Gold is that gold has such great value in small bulk that bullion points are reduced to the narrowest dimensions. To meet even this variation is a subsidiary matter, but need not be entered into till the main issue is settled.

There is this subject of congratulation, the remedy is entirely in our own hands without need to refer to international conferences—barely a necessity of an appeal to Parliament, the acts of which are the cause of the evil. Ordinary people would hardly be aware of a change of method.

Monetary systems cannot be invented, but must grow by trial and error. Left alone, the public will create all the money it wants. Even hampered by the most vicious system Parliaments in their ignorance can devise, the English have evolved the most efficient monetary machine the World has ever known, which as soon as freed from Government shackles will at once grant an increase to the National income and a freedom to the individual far beyond any present imagination.

Essay No. II.—THE EXAMPLE OF SCOTLAND

The fact that this country has been off its gold standard seven times in the past 125 years, and for over 30 years during that period, must surely be evidence enough that the theory on which the constitution of the Bank of England is founded is fundamentally unsound. An internal currency system depends naturally on the general credit of our community and need have no relation with the movements of its standard except as it affects rates of interest, that safety valve of commerce.

We are continually hearing the phrase that gold is the base of credit. Gold is no more a basis of credit or credit circulation than any form of wealth in immediate demand; its function is as a measure of value, wherein it excels any other form of "present capital"; in a state of freedom a reserve of it forms a loan fund to accommodate foreign currencies not clearable through our clearing house for credits.

But there is no need to theorise, the concrete example of Scotland disproves the soundness of English theory as practised by the Bank of England throughout its history.

Scotland's Money Machine

The currency of each country moves within its own legal orbit independently, and Scotland has a legal orbit of its own. The Money Machine of Scotland may be said to have been founded about 180 years ago by the establishment of a very limited number of Joint Stock Banks issuing their own £1 notes unhampered by any privileged dominant central bank. During all that long period the Scotch £1 note has ever been at parity with what was legal tender at the Bank of England, whether it was a gold sovereign or a paper £1. Scotland

ever escaped those financial storms that devastated England in 1782 after the American War, 1793–1796, when England first went off the gold standard for 20 years, and the constantly recurring crises from 1816 to 1854. In 1809, when a crash came that ruined English banks wholesale, it was noticeable that the Newcastle Clearing House Banks agreed to copy Scotland and to accept each other's notes and escaped any disturbances. The condition of Ireland, constrained to copy the English system, was pitiable.

After Waterloo, Scotland had a struggle with Peel to retain its small note issue, and became the one efficient and prosperous quarter of the Realm. These "pocket money" notes of the Scotch banks, forming part of their credit advances, expand and contract naturally without disturbance according to the needs of commerce: the rate of interest being fixed naturally in competition maintains parity with "Sterling" in the London world market, avoiding the arbitrary fixing a rate by a Central Institution.

The English banking establishments were then too numerous and scattered to come to an agreement like Scotland, and were, moreover, constrained by statute to get their "pocket money" from the Bank of England.

Peel and the Bank of England

By 1840 England was on the verge of collapse when some eminent bankers pointed out that the fault lay with the constitution of the Bank of England, that her gold and credit reserves were mixed and held in one department, and any action the Bank was obliged to take from time to time to replenish her gold hoard spread ruin through the country. Peel was persuaded to divide the Bank and urged to confine its note issues to the Issue Department against gold in reserve point for point. To avoid paying off a Government debt to the Bank, Peel "watered" the note and destroyed the fundamental principle the Act was intended to achieve.

The result is that the market had to regulate the foreign exchanges by their relative indebtedness; foreign currencies thus failing to get full support, fall to a discount, foreign goods flood all our markets at home or abroad at prices far under cost values, ruining agriculture and enterprise, depressing wages to meet such practically subsidised competition, thus stimulating over population of a C.3 class. The process was bound to end in the present collapse, which was foreseen 40 years ago. Other countries have copied our system, and suffered accordingly; but the root of the whole mischief is the constitution of the Bank of England.

Properly the rate of interest charged for the issue of the credit notes should be such as to keep the paper £1 on a parity with the sovereign; but with gold at 30% premium, this is not immediately possible until the gold reserve is held in a proper manner. The Governor of the Bank and the Clearing House banks could agree upon the method without need of a reference to the House of Commons, that created the mess, and avoiding the snare of conferences.

Separate Gold Reserves

In 1903 the late Herbert Tritton proposed as an urgent necessity, the formation of a separate gold reserve by the banks; which, though held in the Bank of England, should not be merged in that Bank's figures, but be at the disposal of each depositor in detail. Later Sir Edward Holden formed a reserve of gold at the Midland Bank. By the Act of 1928, the Bank of England obtained power to commandeer any gold reserves, and this unprincipled action is the probable cause of the rapid slump and crises since. It must be remembered that now the banks have to keep about 100 million, at no profit to themselves, to support the Bank of England, and assure themselves from being crushed by the Bank's action; moreover, the taxpayer is involved in 350 million lent the Bank for Exchange Account.

The Treasury reap the profit on the Bank of England note issues; slight reasoning will show that this profit properly belongs to the banking community, its security either in scrip or deposits; therefore the rate of interest required to maintain gold in the reserves should be very properly a first charge on the above profit.

Foreign exchange is a case of pure barter of the bills and claims of each separate country against our own, plus the enormous sums for interest on loans or services in favour of London.

These balances must be met daily, if parity is to be maintained, by loans of present capital—Gold is present capital in its most concentrated form of value—hence the constant necessity of a reserve immediately usable to lend or sell, since it alone can be met at full parity for internal currency that can pass through the bankers' Clearing House. So soon as our gold reserve can be moved with freedom and the Treasury stop regulating exchange and interfering with the freedom of the Money Market, the financial impasse is ended.

"*That Scheme of Iniquity*"

The Industrial Revolution and the mass of poverty characteristic of England the last two centuries has been occasioned by the statutory constitution of the Bank, which makes that institution solely responsible for maintaining a gold reserve, an impossible position for any one institution. Law imported a similar principle into France, which brought that country to ruin in sixty years. England only just escaped a similar fate by Pitt's policy, leaving gold to look after itself in a free market, to return after 1815 for forty years' miserable peace. As early as 1730, Bolingbroke, seeing the approaches of growing national perversion and ruin, termed the Bank's Charter "That scheme of iniquity."

So long as the Gold in the Bank of England's vaults exceeds the Deposits under the heading banks and other accounts, the change over is merely a matter of account:

the chiefs of the ten Clearing House banks and the Governor of the Bank of England in a parlour should be able to unravel the tangle. These Deposits must be met in sovereigns or gold at full parity to avoid utter confusion.

As far back as 1897, the Clearing House memorialised the Government on Sir Michael Hicks-Beach's alarming project that the then Mint regulations relieved the Market from embarrassment on the question of the Standard of Value, and if the exchange merchants and their bankers could keep their bullion accounts and deposits earmarked at the Bullion Department, their last source of embarrassment would disappear.

The interest offered by each and everyone of the above to maintain their separate gold reserves and the interest the Community would pay for the use of the currency note would oscillate in close sympathy, and parity be thus maintained betwen the Sterling Pound and the gold sovereigns. Until this is so, everyone trades at the risk of ruin.

Essay No. III.—PROSPERITY 1919—1922

Following the victory of 1918 came a period of prosperity such as England had not experienced for fifty years previously.

It has been alleged that since gold sold in the open market was at a premium over its established price, therefore the whole circulation of the Realm was inflated. But it must be recollected that our reserve of the standard held at the Bank of England was arbitrarily immobilised.

Thus as the Foreign Exchanges could not be liquidated the premium was a sequence, a price paid to avoid further loss by depreciation. The Bank also demanded of the Clearing House bankers their independent gold holdings.

When we come to examine our internal circumstances, the evidences are against any inflation of our internal credit circulation. Thus within the three years of 1920, 1921 and 1922, the floating debt was reduced by 453½ millions, the Budgets were balanced, the interest on bank deposits averaged £4 8s. 7d. in 1920 and £4 16s. in 1921. Such rates attracted savings, itself a deflationary action. Interest on advances were 5% to 6%, and had the gold reserve at the Central Institution not been in thraldom, such rates for internal credits could have maintained full parity. The advances were made on adequate security, the circulation was full, and financed production and the national income was double what it is at present with over two million on the dole as a consequence of the subsequent arbitrary deflation.

The flaw in Peel's Bank Act of 1844 was that the note issue, limited in amount, is on a mixed basis—partly gold as present capital, and partly on a fiduciary basis ; as soon as there was a demand for gold for export a severe

action on internal credit had to be made by the Bank. In 1845 an eminent banker pointed out that had the fiduciary portion been represented as a separate note issue, a sort of circulating exchequer bill, Peel's Act could have worked. Hardcastle in his *Banks and Bankers* (1841) points out that under a managed currency the circulation can never be full except when the exchanges are at *par*, and the exchanges never are and never can be at *par*. Hence arises the periods of depression and unemployment.

At the period under review, 1919–22, the Treasury issued the Note that formed our pocket-money currency, and this could be issued to the banks on the demands of commerce without reference to the movement of gold. The circulation of every country revolves within the orbit of its own sovereignty and has no outside connection, except that, if the reserve of its standard is free, interest on advances will automatically maintain credit on a parity with its standard and depreciation elsewhere can be avoided. The Treasury, in view of the huge floating debt, naturally considered it was prudent to fund it in view of high rates demanded for accommodation; but the methods pursued to get favourable terms were very questionable.

These may be quoted in the words of the late Walter Leaf, Chairman of the Westminster Bank, in his book on *Banking*, pp. 183–174 :—

"The banks were approached and received an intimation that the Government had adopted a policy of deflation, and the banks were invited to support it by curtailing their credit facilities." Every effort was made by the Government with aid from the Bank of England to destroy credits.

"The effect was immediate: prices dropped, everyone rushed to realise assets, and the value of securities pledged to the banks fell; . . . . . the banks had to put forth every effort to relieve the strain upon their customers, and the amount of *frozen credits* which they were

carrying became a matter of common talk." (Leaf, *ibidem*).

In consequence, manufacturers who had been extending their works, farmers, labour and the general public were ruined wholesale or had to carry heavily involved estates. It was an iniquity!

A similar policy to the above seems to have been followed in 1932–33 to convert the 5% War Loan to 3½%; this, the favourite investment of small trusts and fortunes, ladies, children and annuitants, entailed great privation on small and helpless victims. The effect was immediate, half a million persons were added to the unemployed that winter; farmers said "the bottom was knocked out of farming," and the prospect was so hopeless that the Government had hastily to inaugurate what it called an agricultural policy with features disconcertingly like Moscow.

Matters could not go on without a complete breakdown, and in the Spring of 1933 the Exchange Equalization Fund, now holding 350 millions of taxpayers' money, was evidently used to manipulate a boom in exports. Sterling, which stood at 13s. 8d. to the £1, was allowed to drop to 12s. Export was stimulated and a temporary benefit resulted sufficient to boast of a return to prosperity. But of course, to avoid loss, the management later sold Sterling at higher prices, since which a sort of see-saw has been set up. In the Autumn of 1934, Sterling fell at one time to 11s. 11d. in terms of the gold *franc* without having such marked effect. In fact, the effect of such artificial action fails at each repetition.

Fortunately the event is in the hands of some twelve skilled, even if bewildered men, the managing directors of the Clearing House banks and the Governor of the Bank of England, and immediate relief is possible almost by a stroke of the pen. Gold is our only possible measure of value, but to settle balances in foreign exchange its movement must be automatic, management is absolutely destructive.

Bagehot, in his classic *Lombard Street*,* pointed out our deep-set malady. He writes: "I have tediously insisted that the natural system of banking is that of many banks keeping their own cash reserve, with the penalty of failure if they neglect it. I have shown that our system is that of a single bank keeping the whole reserve under no effectual penalty of failure."

Nothing short of a revolution could persuade public apathy to attempt a necessary change.

Bagehot also shows the anomalous method our system obliges the banker to adopt in dealing with his spare credits. He has no option but to lend them to a small number of exceedingly wealthy discount houses on a double security, where these can appear in his books as part of his *cash*. This leads to huge gluts of idle *money* with no other opening but foreign investment, which leads to that dis-equilibrium in the exchanges of the debtor country, which, as Professor Schumpeter shows, must in the end strangle the debtor or spell loss to the creditor.

The contention of this pamphlet is that this result can be avoided if the creditor, in this case England, holds his reserve in a natural manner so that its regulation is automatic, as has been shown by M. Frederic Jenny.

To allege that the War was the cause of the *impasse* is the explanation of ignorance, it was merely the episode that hastened the *dénouement*. The end, however long delayed even by a period of peace, was bound to end in collapse or violent catastrophe.

England, through its Third Estate, has been the cause of this world-wide disaster, and the Chancellor of the Exchequer is personally responsible for its continuance as his predecessors were that it has finally occurred.

* Hartley Withers' preface to the 1915 edition brings up to date this most valuable book.

Mr. Playne, in the *Morning Post*, April 6, 1935, writes:—

> "The economic problems of every country are largely the result of governmental actions. Only when left alone is it economically true that *le monde va par lui même*."

This aphorism is nowhere so true as in the realm of finance, and the public apathy is due to instinctively relying on it without observing the attached condition.

Through this lack of vigilance it has allowed its betrayal by the Ministers of its Third Estate of the Realm.

POSTSCRIPT

A quick return to prosperity is possible at any time; the right policy might double the national income within a year of its adoption. It is therefore prudent to consider what reform of taxation would produce the most beneficial results. Experience has taught us that with hard times policy is apt to be dictated by waves of sentimentalism. The English lack the realism and cold lucid logic of the French. With the promise of a large surplus every greedy interest would clamour for remission of taxation; but such taxation that is most mischievous should have prior consideration.

Adam Smith clearly demonstrated that as long as the incidence of taxation is certain, the back adjusted itself to the burden: paralysis of enterprise followed a tax where the incidence was uncertain or capricious. He instances the cases of the England and the Turkey of his day.

The income tax is very heavy; but the incidence of it is certain, and the owners of such portion of it levied on realised property are without argument responsible for the "Dead Weight" debt.

But there is one source of taxation, less than one-tenth of the revenue, wherein the incidence is as uncertain as life itself and as capricious as the scale of levy, which produces more mischief and unemployment than all the other taxes put together and combines all the paralysing evils that attend any capital levy.

This source of taxation is known as the Death Duties, its origin vindictive. On this source that really great man, Mussolini, had no doubt and his first action on coming to power was to sweep this tax away, giving his reason: "The family is the unit of the State; what ruins the family ruins the State." This utterance bears the stamp of Roman greatness.

Another most necessary change involves the subject of a general tariff, and it is unfortunate a large section make the subject a sort of religion and outside debate.

M. Frederic Jenny points out that however perfect the money machine of any sovereign state may be, absolute stability, though most desirable, never actually exists but is in a state of flux at any one time.

Even if the reform of the English system, the great creditor, cured the extreme depreciation of debtor exchanges, there will still exist the less depreciation possible between bullion points.

This variation between bullion points arises from the subservience of a conception, which *money* only is, to the necessities of time and space. This variation moves within the limits of the cost of conveying the standard from one market to another. *Money* is a conception, and within the limit of the home exchange needs not a tangible existence; but in the region of the foreign exchanges it is brought to bed-rock principles and the material conditions which govern its standard, into which it must be exchangeable at full parity.

In the extreme case of London and Australia, the cost of carrying gold is 5% of its value: i.e., 10% between premium and discount at least. This is a serious hindrance to liquidating trade claims, even though the depreciation is less than in so many cases in present-day experience. Either the debtor is cheated in the price of his money in London, or the prosperity of the Home country is impaired.

A flat rate tariff on all imports (except gold and silver), without exception of 10%, would cover cost of the carriage of bullion between distant ports. The effect on our own market would be identical to a payment of gold into the Bank of England and would stabilise all the exchanges as nearly as possible to absolute parity. The overwhelming creditor position of London assures this.

Besides a large revenue, the primary object of all taxation, it saves the foreign debtor being cheated of

his price, and would increase the national income many times the amount of the tax by insuring that imports do not come in under cost *value*, an increase which would automatically be an addition to our wage fund. The operation of the Law of Supply and Demand would be reduced to merely local considerations.

Although after two centuries' subjection to demoralising influences—make no mistake Society is largely demoralised—it may require three generations under healthier conditions to fully recover tone : nevertheless, when the great pocket-money problem of individuals is settled, the more pressing social problems would vanish automatically and much of the hysterical propaganda about presumed social services would not be necessary.

In 1897 the London Bankers' Clearing House memorialised the Government, saying that if exchange merchants and bankers could keep their bullion accounts and deposits earmarked at the Bullion Department, their last source of embarrassment would disappear. It is for the present Chancellor of the Exchequer to translate this into action—there is little else required to remedy the situation.

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